E-commerce, Cellphone Sales Drive Growth In Technology Sector

KEY TAKEAWAYS

The remarkable valuation expansion over the last several years has lifted the technology sector to one of the largest sectors in most global equity market indexes. The sector now accounts for more than 15% of the global free float market capitalization.

The technology sector continues to see strong growth in revenues and earnings, especially in segments such as ecommerce, online entertainment, and web-based services. In the hardware and devices area, continuous innovations and new product features have sustained demand growth. The robust sales volume expansion for cellular phones and other products have also benefited component manufacturers across the globe as well. Despite the rapid pace of expansion, many of these market segments are far from saturation. Relatively low market acceptance for some of these services in less developed countries offer the possibility of accelerated growth for several years to come. Nevertheless, current equity market valuations of some of these businesses already factor in part of the future revenue expansion. Those businesses that have positive cash flows, and hence are less dependent on external capital, appear better placed to survive any slowdown in demand growth.

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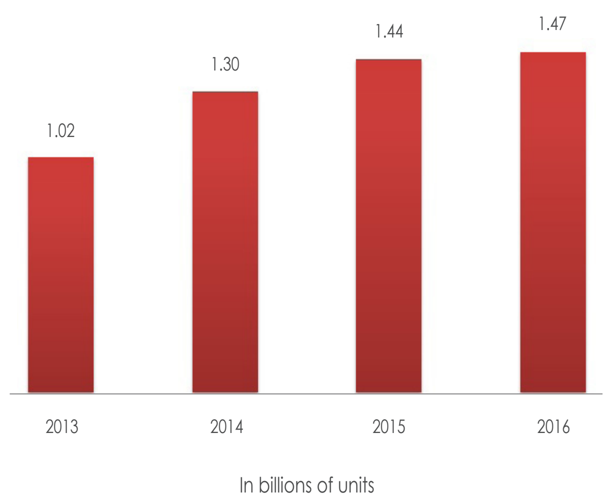
Smart phone shipments show robust growth



Data source: Bloomberg's Total Mobile Shipment Smartphone Index (TOA3SPHO Index) of the global free float market capitalization. In emerging markets, the technology sector dominates with more than a 28% share of the free float capitalization. The largest technology companies are now household names, disrupting older business models, and are widely followed by analysts. These unprecedented changes and the pace of growth has immensely benefited investors and there is broad consensus that the expansion can continue.

Cellphones and other handheld devices have become ubiquitous, even in large emerging economies where average income levels are still low. Despite this apparent market saturation, manufacturers of handheld devices such as cellphones continue to see healthy demand from product replacement and upgrades. With the addition of new functions and updates, these devices have even become effective tools in improving workplace productivity. As a result, the leading manufacturers still command considerable pricing power. Given the potential for product upgrades in some of the large emerging markets, where consumers are becoming more affluent, the demand outlook for devices remains bright.

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The market valuations of ecommerce and other online service providers continue to expand as most of these businesses are tapping new technologies to create demand, or disrupting and replacing old business models. This is most visible in sectors such as retail where older players are struggling. The ability to offer more services on currently available platforms set apart the providers that can continue to grow for several years. There is also potential for geographic expansion as most of the innovations can be easily adapted to markets across the globe. Here again, the current leaders with access to technology, capital and other resources have the advantage over smaller rivals. They are better placed to enter new market segments or geographies, including by way of acquisitions.

While the business prospects remain upbeat for the next several years, the current equity valuations already account for at least part of the future revenue upside. As these market segments continue to evolve and mature, more consolidation is also likely. Companies that are currently dominant, or have healthy cash flows, appear better placed to survive any decline in demand.

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>
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